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UNITED DRUG, INC.

AND

SUBSIDIARY COMPANIES

ANNUAL REPORT

DECEMBER 31, 1936

MRS
CORP. FILE

March 1, 1937

To the Stockholders of United Drug, Inc.:

The Annual Report of your Company, herewith submitted, presents a consolidated balance sheet, consolidated statement of profit and loss and earned surplus for the year ending December 31, 1936.

After providing for depreciation, federal income taxes, federal surtaxes on undistributed profits, bond interest, loss on guaranteed leases and extraordinary flood losses, earnings for 1936 amounted to $2,065,474.50, which is $1.47 per share on the capital stock of the company. This amount, however, included extraordinary income of $843,001.64 and extraordinary deductions of $509,933.78, as per accompanying statement of profit and loss.

It will be noted that working capital shows a net reduction for the year of $1,388,823. This is due principally to the expenditure of approximately $2,135,000 for real estate, machinery and equipment, store fixtures and improvements; a reduction of $308,100 in bonded indebtedness, and additional income taxes for previous years of $543,818, paid or provided for, in respect of the repurchase of the Liggett and Owl Companies. The total of such expenditures is substantially more than the increase in resources represented by the portion of earnings which were not distributed in the form of dividends. The income taxes referred to above were charged to reserve for contingencies which was set aside as at December 31, 1935 for this purpose.

Earned surplus as of December 31, 1936 amounted to $5,418,112.05, a net increase of $1,043,764.34 for the year, after payment of dividends of seventy-five cents per share amounting to $1,020,597.75.

In the report of last year it was stated that the directors might authorize the writeoff of a portion of our consolidated goodwill account. This matter was deferred, pending the settlement of the income tax and other questions relating to the repurchase of the Liggett and Owl Companies. The Management will recommend to the Board of Directors at the annual meeting in March that the goodwill account be reduced from $10,401,169.38 to $7,500,000 by a charge to capital surplus which resulted from the valuation of store fixtures and improvements as of December 31, 1935.

In keeping with the efforts of the Management in previous years, we have conducted a vigorous sales campaign increasing our net volume for the current year by $5,725,221 as compared with the previous year. During the past two years net sales have increased more than $10,000,000. In 1936 dollar sales of drugs, chemicals and pharmaceuticals, etc., by United Drug Company, principal manufacturing subsidiary, were within six percent of the best year in the company's history.

Probably the most extensive advertising campaign that we ever waged was the development and operation of the Rexall Train. This train, built to order, covered forty-eight states and the District of Columbia, holding one hundred and fourteen conventions in the United States and four

in Canada. It was intended to use the train exclusively for the benefit of the Rexall druggists. Before we had been on the road a week, we found that the public was keenly interested. The result was that it became not only a Convention train, but a Show train, 2,360,000 people having seen our mechandise in the exhibit cars. The officers and other executives of this Company met and entertained approximately 30,000 Rexallites, their sales people and members of their families. It was a highly effective publicity move, unique in the annals of merchandising as well as railroading. All expenses were charged out of profits in the year 1936, and your Management feels it was one of the best advertising investments that the Company has ever made.

The profits of our retail stores in 1936 were the best since the formation of the present companies — this despite flood losses in the Spring affecting the Liggett Company; strikes on the Pacific Coast affecting the Owl Company in the Fall; and substantial losses resulting from the Robinson-Patman Act.

Our Canadian manufacturing and retailing companies and our British manufacturing and distributing company all had record earnings in 1936. The rest of our foreign businesses have shown material progress, and have augmented the profits of the above named companies. We are developing in the West Indies, Central America and South America in a very conservative way, and doubtless in the near future the results of this expansion will be comparable with those we have achieved in other foreign countries.

Subject to changes and conditions over which we have no control, we expect substantial results in 1937 from the foundations that have been laid during the past three years.

Action on dividends will be considered at the directors' meeting the first week in May. It is the intention of the Management to recommend that dividends be paid twice a year, with a third payment in December if existing laws regarding undistributed earnings continue in effect.

Respectfully,

Louis K Liggett

President.

PRICE, WATERHOUSE & CO.

75 FEDERAL STREET
BOSTON

March 1, 1937.

To the Board of Directors of
United Drug, Inc.:

We have made an examination of the consolidated balance sheet of United Drug, Inc. and its subsidiary companies as at December 31, 1936 and of the consolidated statement of profit and loss and earned surplus for the year ending on that date. In connection therewith we examined or tested accounting records and other supporting evidence and obtained information and explanations from officers and employees of the companies; we also made a general review of the accounting methods and of the operating and income accounts for the year, but we did not make a detailed audit of the transactions.

The accompanying statement of profit and loss includes a provision for depreciation of store fixtures and improvements of the retail companies based on the valuations assigned to these assets as at December 31, 1935, as explained in the President's report to the stockholders dated March 7, 1936, plus subsequent additions at cost. The provision for depreciation of such assets is approximately $160,000 less than the amounts charged to profit and loss in the preceding year for additional equipment purchased, leasehold improvements and replacements, in lieu of depreciation. The rates of depreciation used in the preceding year for certain assets of the manufacturing companies have been reduced, resulting in a further decrease in the provision for depreciation for the current year amounting to approximately $65,000.

In our opinion, based upon such examination, the accompanying consolidated balance sheet and related statement of profit and loss and earned surplus fairly set forth, in accordance with accepted principles of accounting consistently maintained (except as noted in the second paragraph above), by the companies during the year under review, the position of United Drug, Inc. and its subsidiary companies at December 31, 1936, and the result of their operations for the year ending on that date.

PRICE, WATERHOUSE & CO.

UNITED D
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CONSOLIDATED BALANCE

ASSETS

CURRENT ASSETS:			
Cash in banks and on hand		$ 8,520,842.37	
Short-term and call loans		1,555,000.00	
Miscellaneous marketable securities (*value based on December 31, 1936 market quotations—approximately $562,000*)		395,040.92	
Accounts and notes receivable:			
Customers' accounts and notes	$4,627,672.86		
Miscellaneous	394,330.30		
	$5,022,003.16		
Less—Reserve for doubtful balances, discounts, etc.	368,039.09	4,653,964.07	
Inventories of merchandise, partly finished stocks, materials and supplies, certified as to quantities and condition by responsible officials (*at cost, not exceeding market*)		18,706,414.56	$33,831,261.92
INVESTMENTS AND ADVANCES, ETC.:			
Customers' notes receivable and advances, less reserves		$ 387,026.38	
Miscellaneous advances, claims and deposits, less reserves (*including $66,862.56 due from employees*)		722,511.05	
Miscellaneous investments, at or below cost		501,885.29	1,611,422.72
UNITED DRUG, INC. CAPITAL STOCK—39,767 shares owned by subsidiary company, at cost			456,937.68
PROPERTY ACCOUNTS—at cost, written down amounts, or appraisal valuations (*including store fixtures and improvements of retail companies at appraisal valuations determined in 1933, as approved by the directors, plus subsequent additions at cost*):			
Land, buildings, and building fixtures		$ 9,053,046.68	
Machinery and equipment, etc.		8,213,862.07	
Store fixtures and improvements		7,911,258.75	
		$25,178,167.50	
Less—Reserve for depreciation and amortization		10,924,612.88	14,253,554.62
PREPAID INSURANCE, TAXES, RENT, ETC., AND ADVERTISING SUPPLIES			754,555.56
GOODWILL, TRADE-MARKS, ETC.			10,401,169.38
			$61,308,901.88

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RY COMPANIES
SHEET—DECEMBER 31, 1936

LIABILITIES

CURRENT LIABILITIES:		
Accounts payable, accrued expenses, etc.	$ 6,516,512.47	
Accrued interest on funded debt	520,152.49	
Provision for federal and foreign taxes on 1936 and prior years' income	873,272.86	$ 7,909,937.82
FUNDED DEBT:		
Twenty-five year 5% debenture bonds of United Drug Company, due March 15, 1953:		
Authorized and issued, $40,000,000 less $2,250,000 retired	$37,750,000.00	
Less—In treasury, held for retirement (*including $750,000 principal amount available to meet the sinking fund payment due March 15, 1937*)	2,082,400.00	35,667,600.00
RESERVES FOR:		
Miscellaneous deferred income, etc.	$ 117,730.17	
Maintenance of store fixtures and improvements	212,581.24	
Contingencies (*after deducting charges thereto in 1936 in respect of final settlement of old lawsuit, $32,000, and prior years' federal income and state taxes, paid or provided for, which resulted from the realization of assets of the retail companies acquired in 1933 and 1934, $543,818.63*)	1,098,756.01	1,429,067.42
CAPITAL STOCK:		
Authorized and issued, or to be issued—1,400,560 shares, par value $5 each		7,002,800.00
CAPITAL SURPLUS		3,881,384.59
EARNED SURPLUS, representing principally net earnings of subsidiary companies since September 1, 1933 which have not been distributed to the parent company—per accompanying statement		5,418,112.05
CONTINGENT LIABILITY:		
For portion of such liabilities as may result to Drug Incorporated.		
		$61,308,901.88

UNITED DRUG, INC.
AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF PROFIT AND LOSS AND EARNED SURPLUS FOR THE YEAR ENDING DECEMBER 31, 1936

Sales, less returns, allowances and discounts			$88,464,982.00
Cost of sales, selling, general and administrative expenses (*including depreciation of* $977,922.50)			84,537,957.95
Profit from operations			$ 3,927,024.05
Other income:			
Income from investments		$ 37,628.93	
Interest on notes receivable, etc.		49,403.20	
Miscellaneous		74,147.60	161,179.73
			$ 4,088,203.78
Other charges and income taxes:			
Interest on funded debt		$ 1,810,985.17	
Federal and foreign income taxes (*including* $46,089.02 *in respect of prior years*)		430,098.53	
Federal surtax on undistributed profits		100,613.72	
Miscellaneous		14,099.72	2,355,797.14
Profit for the year before extraordinary income and charges			$ 1,732,406.64
Extraordinary income and charges:			
Excess of proceeds from the sale of investment over book value thereof (*after deducting provision for federal income taxes,* $170,000, *and surtax on undistributed profits,* $45,000, *applicable thereto*)		$ 843,001.64	
Deduct:			
Loss from operation of guaranteed leases	$383,195.18		
Merchandise, fixtures, etc., destroyed or damaged by floods	126,738.60	509,933.78	333,067.86
Net profit for the year			$ 2,065,474.50
Consolidated earned surplus balance, December 31, 1935			4,374,347.71
			$ 6,439,822.21
Deduct:			
Cash dividends paid		$ 1,020,597.75	
Premium on purchase of bonds of United Drug Company		1,112.41	1,021,710.16
Consolidated earned surplus balance, December 31, 1936			$ 5,418,112.05

OFFICERS

Louis K. Liggett	*President*
George M. Gales	*Vice-President*
Joseph A. Galvin	*Secretary and Treasurer*
W. Newlin Mitchell	*Assistant Treasurer*

DIRECTORS

Charles Francis Adams	*Chairman*, Board of Directors, State Street Trust Company, Boston
George M. Gales	*President*, Liggett Drug Company, Inc., New York
George C. Haigh	*Vice-President*, Bank of the Manhattan Company, New York
Louis K. Liggett	*President*, Boston
Warren Motley	Gaston, Snow, Saltonstall, Hunt and Rice, Boston
Charles S. Munson	*President*, U. S. Industrial Alcohol Company, New York *Vice-President and Director*, Air Reduction Co., Inc., New York
James L. Richards	*Chairman Board of Trustees*, Massachusetts Gas Companies, Boston
Fred S. Rogers	of McMonagle and Rogers, Inc., Middletown, New York
Eugene W. Stetson	*Vice-President*, Guaranty Trust Company of New York, New York

Transfer Agents

Guaranty Trust Company of New York, New York
State Street Trust Company, Boston

Registrars

The Chase National Bank of the City of New York, New York
The National Shawmut Bank of Boston, Boston

Counsel

Gaston, Snow, Saltonstall, Hunt and Rice, Boston
Root, Clark, Buckner and Ballantine, New York